BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF DELMARVA POWER & LIGHT COMPANY FOR AN INCREASE IN ELECTRIC BASE RATES AND MISCELLANEOUS TARIFF CHANGES (Filed August 17, 2017)	)))))	PSC DOCKET NO. 17-0977

REVISED PREFILED DIRECT TESTIMONY

OF

LARRY BLANK

ON BEHALF OF

THE PUBLIC SERVICE COMMISSION STAFF

June 8, 2018

Contents

EXHIBITS

I. IDENTIFICATION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.

A. My name is Larry Blank. My business address is TAHOEconomics, LLC, 6061 Montgomery Road, Midlothian, TX 76065. My email address is LB@tahoeconomics.com.

Q. WHERE ARE YOU EMPLOYED?

A. I am the principal of TAHOEconomics, LLC ("Tahoe"), a Texas-registered consulting firm, specializing in most policy and ratemaking facets of regulated utility industries. I first established this company in Nevada in August 1999. I am also an Associate Professor of Economics and Associate Director with the Center for Public Utilities in the College of Business at New Mexico State University ("NMSU"). For the purposes of this proceeding, I have been engaged through Tahoe, the expert opinions expressed herein are my own, and nothing in this testimony necessarily reflects the opinions of NMSU.

Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR BACKGROUND AS IT IS RELEVANT TO THIS TESTIMONY.

A. I have served the public in various capacities for over twenty (25) years. I received a Ph.D. in Economics from The University of Tennessee in 1994, specializing in Industrial Organization & Public Policy (including regulatory policy), Econometrics, and Finance. Following completion of my Ph.D., I served as an Economist with the National Regulatory Research Institute ("NRRI") at the Ohio State University and later as the Manager of Regulatory Policy & Market Analysis with the Regulatory Operations Staff

of the Nevada Public Utilities Commission. My division's responsibilities in Nevada included participation in several rulemaking workshops and rate cases for all regulated utilities in that jurisdiction as well as expert witness testimony on the same. As a consultant, I have served a variety of clients including regulatory agencies, utility customers, utility companies, and Federal Agencies including the U.S. Department of Energy as the Project Director for technical assistance to the Energy Regulatory Commission in the Philippines. I have served as an expert witness and/or advisor in over 160 rate cases and rulemakings of various types and have previously filed written testimony in the following utility regulatory commission jurisdictions: Alaska, Arizona, Arkansas, Colorado, Delaware, Montana, Nevada, New Mexico, Oklahoma, Texas, and the Federal Energy Regulatory Commission. As a professor, I teach advanced graduate utility regulation to Masters students in economics, engineering, and management at NMSU who have decided to specialize in this profession. I also direct an executive Graduate Certificate Program in Public Utility Regulation & Economics, and I help deliver nationally-recognized rate case training programs, which are attended by hundreds of regulatory professionals from across the United States and are endorsed by the National Association of Regulatory Utility Commissioners ("NARUC"). My resume is attached as Exhibit LB-1.

Q. HAS TESTIMONY PREVIOUSLY BEEN FILED IN YOUR NAME WITH THE DELAWARE PUBLIC SERVICE COMMISSION?

A. Yes. I prepared written testimony filed with the Commission in the last Delmarva electric rate case in Delaware, Docket No. 16-0649.

II. PURPOSE AND SUMMARY

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. I am testifying on behalf of the Delaware Public Service Commission Staff ("Staff") and addressing the following components of the electric rate case filing by Delmarva Power & Light Company ("DPL" or the "Company"):

1. The Company's jurisdictional allocations separating transmission and the states in which the Company operates.
2. Affiliate transactions charged to DPL, which is seeking recovery of those costs in Delaware rates.
3. The Company's class cost of service study and the development of Staff's recommended rate class revenue requirements.
4. The Company's rate design and Staff's recommended distribution rates.

Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR KEY FINDINGS.

A. First, I recommend the Delaware Public Service Commission ("Commission") order its Staff to investigate and pursue possible changes in the Company's transmission formula rate before the Federal Energy Regulatory Commission ("FERC"). Specifically, this would include, but not necessarily be limited to, pursuing a change in the use of the "Wages & Salary Allocation Factor", also known as a direct labor allocator, for the allocation of General & Common Plant and Expenses. Herein I provide an illustrative example of the possible effect of my recommendation. Utilizing this Delaware filing, a just and reasonable allocation across jurisdictions would produce a $32,725,417 reduction in jurisdictional rate base, and a $14,169,325 reduction (before income taxes) in the distribution expenses for the Delaware jurisdiction. This is the result of conforming the

jurisdictional allocation of DPL's general and administrative costs with that of the affiliate service companies causing those charges onto DPL using methods consistent with those accepted by FERC.

Second, I recommend the Commission accept my changes in the labor allocation method employed by the Company for the jurisdictional split of general and common costs between Maryland and Delaware by rejecting DPL's use of gross plant and adopting operation and maintenance ("O&M") expense as a far more appropriate proxy for direct labor. A proxy for direct labor is required by the fact that the Company does not have direct labor values that are Maryland and Delaware specific. In this regard, the O&M expenses in Delaware must be adjusted for allocation ratio purposes only to conform to the Maryland treatment of storm damage costs.

Third, I raise concerns regarding what seem to be accounting discrepancies for affiliate transactions; specifically, very large amounts of internal service company costs booked to DPL's Account 923, Outside Services, thereby, greatly reducing transparency.

Fourth, I accept the results of the DPL class cost of service study as a reasonable way to guide the allocation of the distribution revenue requirement between the Delaware rate classes.

Fifth, I recommend a slight deviation from the strict application of the cost of service results in the final determination of rate class revenue requirements. Specifically, I suggest that those rate classes that would receive large rate increases be held to current rates, which will help mitigate a large implied increase for residential space heating customers and primary general service customers.

Finally, I provide the rationale for the residential rate design, and Staff's recommended rates for each rate schedule.

III. JURISDICTIONAL DISTRIBUTION REVENUE REQUIREMENT

Q. IS DELMARVA POWER & LIGHT PART OF A MULTI-JURISDICTIONAL HOLDING COMPANY STRUCTURE?

A. Yes. DPL is a gas distribution company in Delaware and an electric distribution and transmission operating company primarily operating within the Federal, Maryland, and Delaware jurisdictions but is also part of the Exelon Corporation holding company structure that includes five other regulated utility operating companies in addition to DPL: Commonwealth Edison Co., PECO, Pepco, Atlantic City Electric Co., and Baltimore Gas & Electric Co. In terms of utility regulation, Exelon controls operating companies within at least seven jurisdictions: Federal, Delaware, the District of Columbia, Illinois, Maryland, New Jersey and Pennsylvania. In addition to its regulated energy delivery companies, Exelon Corporation, through multiple subsidiaries, is one of the largest U.S. power generators, with more than 35,500 megawatts of nuclear, gas, wind, solar and hydroelectric generating capacity.[1] Exelon Corporation also owns Potomac Capital Investment Corporation with multiple subsidiaries. "Potomac Capital Investment Corporation engages in leasing power generation and transmission facilities including hydroelectric facilities in Austria; gas and coal fueled power plant located in the Netherlands; a coal fuel power plant in Australia; and gas transmission and

[1] Source: Exelon website.

distribution networks in the Netherlands. Potomac Capital Investment Corporation operates as a subsidiary of Exelon Generation Company, LLC."[2]

Q. HAS THE COMPANY PROVIDED AN ORGANIZATIONAL CHART FOR EXELON CORPORATION?

A. Yes, this was provided by DPL as Schedule (JEG)-2, Direct Testimony of Julie E. Giese. The Company claims this organizational chart is "CONFIDENTIAL."

Q. WOULD YOU CHARACTERIZE EXELON CORPORATION AS A COMPLEX HOLDING COMPANY STRUCTURE?

A. Yes.

Q. ARE THERE MONETARY SERVICE TRANSACTIONS BETWEEN AFFILIATED COMPANIES WITHIN EXELON CORPORATION?

A. Yes, there are substantial affiliate transactions throughout the Exelon Corporation. For example, DPL was charged for services/costs from nine (9) different Exelon subsidiaries during 2016-2017. See Schedule (JEG)-3, Direct Testimony of Julie E. Giese. During calendar year 2016 (test period), DPL was charged over $375 million by affiliated companies, which is about 30% of DPL's total annual expenses and is the majority of DPL's administrative and general expenses. The dominant affiliate service transactions charged to DPL originate from two Exelon-controlled service companies, Exelon Business Services Company (EBSC) and PHI Service Company (PHISCO).

Q. HOW DO EBSC AND PHISCO ASSIGN AND ALLOCATE COSTS TO OTHER ASSOCIATED COMPANIES?

[2] Source: Bloomberg, https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=698385

A. These methods are described in the PHI Cost Allocation Manual ("CAM") and the service agreements provided with the Direct Testimony of Julie E. Giese, Schedule (JEG)-1. Both EBSC and PHISCO seem to follow standard accounting practices in that service company costs incurred are first directly charged to the appropriate affiliate and then the residual costs are allocated using one of several allocation methods that vary depending on the nature of the cost classification. The PHI CAM, at page 5, describes the corporation costing philosophy as a "three-tiered approach" with 1. Direct Assignment; 2. Direct Charging; and 3. Allocation (for "costs which cannot be directly assigned or charged from a Service Company"). PHISCO's General and Administrative costs are predominantly allocated using a "Two Factor Ratio," and EBSC's General and Administrative costs are predominantly allocated using a "Modified Massachusetts Formula." As noted by Ms. Giese at page 3, lines 20-21, "[b]oth ratios are size-based composite ratios and are similar in nature." I would also note that these methods are consistent with variants of the Massachusetts Formula that have been accepted by the Federal Energy Regulatory Commission (FERC). It is called the "Massachusetts Formula" based on the Commission decision in *Distrigas of Massachusetts Corp*, 41 FERC ¶ 61,205 (1987).[3]

Q. WHAT IS THE TWO FACTOR RATIO METHOD USED BY PHISCO TO ALLOCATE GENERAL COSTS TO AFFILIATES?

A. The Two Factor Ratio ("TFR") method used by PHISCO is an equally weighted average of the operation and maintenance expense factor and the gross plant factor. The following example was provided by DPL in response to our discovery:

[3] For an electric transmission example, see Order on Complaint, 127 FERC ¶ 61,043, Docket No. EL09-11-000, April 16, 2009 (including footnote 27).

PHI Service Company (PHISCO) Two factor Ratio - Example as of June 30, 2017	PHI Holdco	ACE	DPL	Pepco	Total
Items (in millions)					
Operating and Maintenace	$ 1	$ 274	$ 275	$ 423	**$ 973**
Operating and Maintenace Percentage	0.10%	28.16%	28.26%	43.47%	**100.00%**
Gross Property Plant and equipment	$ -	$ 3,670	$ 4,623	$ 8,889	**$ 17,182**
Property Plant and equipment Percentage	0.00%	21.36%	26.91%	51.73%	**100.00%**
Allocation Percentage- Two Factor Ratio	0.05%	24.76%	27.58%	47.60%	100.00%

Q. WHAT IS THE MODIFIED MASSACHUSETTS FORMULA USED BY EBSC TO ALLOCATE GENERAL COSTS TO AFFILIATES?

A. The Modified Massachusetts Formula ("MMF") used by EBSC is an equally weighted average of three factors: 1. Gross Revenues, 2. Assets, and 3. Direct Labor. The following example was provided by DPL in response to our discovery:

Modified Massachusetts Formula - EED Client Companies only (ComEd, PECO, BGE, ACE, DPL, Pepco)(millions)	DPL	Total
Gross Revenues	$ 1,294	$ 16,665
Assets	$ 4,151	$ 63,036
Direct Labor	$ 82	$ 1,548
	6.56%	100.00%

Q. HOW DO THESE EXELON-CONTROLLED SERVICE COMPANY ALLOCATED COSTS IMPACT DPL'S REVENUE REQUIREMENT IN THIS RATE CASE?

A. About 75% of DPL's electric administrative and general ("A&G") expenses and 30% of electric general plant in service are due to these cost allocations from the service companies. The allocations to DPL are driven by total DPL operations, including gas,

electric distribution, and FERC-jurisdictional transmission. To maintain cost-causation consistency, the allocation of A&G costs to the three DPL electric jurisdictions, FERC, Maryland, and Delaware, should follow a methodology consistent with the service company allocations. In other words, the factors that determine the allocation of service company A&G costs to the whole DPL should be the same factors used to allocate those A&G costs in this rate case to the transmission, Maryland distribution, and Delaware distribution functions (the electric parts of the whole). This is the only way to preserve the principle of cost causation within the jurisdictional separation. Use of a significantly different allocation factor for the transmission and distribution parts of DPL than that used by the service companies will cause a distortion in cost allocation away from the factors that caused those costs to be incurred by DPL in the first place.

Q. WHAT IS THE BEST METHODOLOGY AVAILABLE TO ACHIEVE CONSISTENCY BETWEEN THE SERVICE COMPANY A&G ALLOCATIONS AND THE ALLOCATION OF DELMARVA COSTS TO THE THREE ELECTRIC JURISDICTIONS?

A. Most of the service company costs come from PHISCO and they use the TFR methodology for most of A&G. An alternative would be the MMF approach used by EBSC, but the EBSC allocated costs are a much smaller portion of the total charged to DPL and there is a shortcoming in the direct labor ratios used by DPL because they do not have state-specific direct labor amounts. Therefore, the preferred approach is the TFR method used by PHISCO.

Q. WHAT METHOD HAS DELMARVA USED TO ALLOCATE A&G COSTS TO THE FERC, MARYLAND, AND DELAWARE JURISDICTIONS?

A. In its development of the Delaware jurisdictional revenue requirement in this case, the Company used a direct labor ratio approach for allocating general plant and A&G expenses.

Q. DO YOU HAVE ANY CONCERNS REGARDING THE WAY IN WHICH DPL CALCULATED THESE JURISDICTIONAL ALLOCATION FACTORS?

A. Yes. Their computation of the "Labor Allocators" does not produce a true labor allocator in that the Delaware and Maryland factors are actually determined by a gross plant allocation factor. Therefore, the "Labor Allocators" are actually a mix between labor cost and gross plant. Furthermore, a large portion of direct labor costs for transmission are actually performed by PHISCO and it is not clear whether these are included in the annual amount used by DPL, which is only $2,544,316, or if this amount only includes DPL employees, which would greatly understate the transmission operation and maintenance labor by that amount performed by PHISCO.

Q. IF THE CALCULATIONS OF THE LABOR ALLOCATION FACTORS WERE CORRECTED, WOULD YOU SUPPORT THEIR APPLICATION FOR THIS PURPOSE?

A. No. First, most of the DPL A&G costs originate from the PHISCO and EBSC service companies and are determined using the composite allocation methods (TFR and MMF) described above and, therefore, are not caused solely by direct labor costs. In other words, the DPL A&G costs are predominantly caused by the TFR and MMF used by PHISCO and EBSC, not direct labor. Second, general plant and common plant and the associated administrative and general expenses support the entire company, which is not limited to labor, but all operations, maintenance, and capital. For example, the salaries of

the financing officers of the company primarily support capital (plant), company officers in transmission and distribution planning support that infrastructure (plant), the salaries of the purchasing department primarily support non-labor operation and maintenance, and the legal and accounting departments support all aspects of labor, operations, and capital. In turn, these support personnel are supported by general plant and the executives of the company. Therefore, a pure labor allocation factor does not sufficiently capture the drivers of general and common costs.

Q. DOES THE DPL LABOR RATIO RESULT FOR TRANSMISSION SEEM UNREALISTICALLY LOW?

A. Yes. Transmission is responsible for 37.46% of DPL's total operational plant in service and 24.61% of DPL's total operation and maintenance expense; however, DPL's labor ratio result suggests that transmission is only responsible for 7.07% of administrative and general costs. This is a very unrealistic and inconsistent with common sense expectations. DPL admitted the following in discovery:

QUESTION NO. PSC-COS-15

Please confirm that Exelon Business Services Co. and PHI Service Company devote more than 8% of their resources to matters pertaining to transmission and other non-distribution investment, financing, operation, and regulatory issues during the course of one year. If correct, please provide a more accurate percentage of time committed to non-distribution activities. If not correct, then please provide evidence of what the appropriate percentage is.

RESPONSE:

It is confirmed that there was more than 8% charged to transmission O&M and capital, and other non-operating accounts, based upon 2016 data. An analysis determining the percentage of time spent for each of these activities for the Exelon Business Services Co. and PHI Service Company is not available.

Q. DOES THE USE OF DIRECT LABOR RATIOS TO FUNCTIONALIZE OR ALLOCATE A&G COSTS HAVE A LONG HISTORY IN PUBLIC UTILITY RATEMAKING?

A. Yes. The use of labor ratios to functionalize A&G expenses and General or Common Plant in service originated at a time when most utility companies were stand-alone operating companies not part of large holding company structures. In the electric industry, labor ratios may have served this purpose well when electric utilities were predominantly stand-alone, vertically integrated companies owning and controlling generation capacity, transmission capacity, distribution facilities, and retail electric service. This was a time when affiliate transactions were much less common and materially insignificant. That world has changed substantially for many utility companies including DPL as I have described above.

Q. HOW HAS THE WORLD CHANGED SINCE THE TIME DIRECT LABOR RATIOS WERE ADOPTED AS A DEFAULT ALLOCATOR FOR GENERAL AND ADMINISTRATIVE COSTS?

A. First, the expansion of holding company structures and the reliance of central service companies to perform work for multiple affiliates has changed cost causation. Second, the restructuring of the electric utility industry including the divestiture of generation from the regulated utility operating company and the creation of regional transmission

organizations has caused there to be more affiliates served by centralized holding company service companies. Third, the adoption of more sophisticated accounting practices to assign and allocate service company costs to regulated and non-regulated affiliates no longer follow the old direct labor ratio approach because experts recognized the inaccuracy with that old methodology under the more complex corporate structure. As an example of these more sophisticated accounting practices, see the CAM with the Direct Testimony of Julie E. Giese, Schedule (JEG)-1. Fourth, the FERC has long recognized that these more complex corporate structures with multiple affiliates served by centralized holding companies require the use of functionalization and allocation methods that better match costs with beneficiary affiliates.

Q. IS THE PHISCO TFR METHOD THE SAME AS WHAT YOU PROPOSED IN THE LAST DPL RATE CASE?

A. The PHISCO TFR method is similar to what I proposed last time in Docket No. 16-0649, except last time I used net plant rather than the gross plant included in the TFR. This time I am fully conforming to the PHISCO methodology for determining the A&G costs of DPL.

Q. WOULD APPLICATION OF THE TFR APPROACH OR THE MMF APPROACH FOR TRANSMISSION ALLOCATION REQUIRE DPL TO MODIFY ITS FORMULA RATES WITHIN THE FERC JURISDICTION?

A. Yes. DPL has formula rates within the PJM RTO Open Access Transmission Tariff (OATT) under the FERC jurisdiction. The DPL OATT formula rates currently use the same flawed labor ratio in the calculation of transmission revenue requirement. It is my understanding that a change in the DPL FERC-jurisdictional formula rates to substitute a

new allocation method for the Wages & Salary Allocation Factor currently in use is a change in the underlying structure of the DPL formula rates that would require a formal filing under Section 206 of the Federal Power Act.

Q. WOULD SUCH A CHANGE WITHIN THE DPL FORMULA RATES OF THE PJM OATT BE TECHNICALLY COMPLICATED?

A. No. Mechanically speaking, this is a simple modification to the allocators within the DPL formula rates. However, the process to make such a change is likely to take some time under a Section 206 filing.

Q. DO YOU THINK FERC WOULD BE WILLING TO CONSIDER SUCH A CHANGE?

A. Yes. Given the complex nature of the Exelon corporate structure and the heavy reliance on Exelon service companies by multiple regulated and non-regulated Exelon companies, including DPL, I think the FERC will recognize the importance of utilizing a composite allocation methodology similar to the Massachusetts Formula it has already accepted for use by others with complex corporate service structures (predominantly for FERC-regulated gas pipelines). Furthermore, the fact that Exelon is already using this widely accepted methodology within its service companies, consistency and cost causation calls for the change within the operating companies as I have explained above.

Q. ARE THERE ECONOMIC EFFICIENCY REASONS FOR SUCH A CHANGE IN THE FERC FORMULA CURRENTLY USED BY DPL?

A. Yes. Currently transmission is underpriced because of the under-allocation of overhead A&G costs. This causes an inefficient market distortion in which DPL transmission may be selected over other more efficient resources, such as distributed generation and/or

storage, because it is currently not priced at its fully allocated cost. The economists at the FERC should recognize the importance of correcting this error.

Q. ARE THERE COMMON COST CATEGORIES WITHIN DPL FOR WHICH THE LABOR ALLOCATION FACTORS ARE MORE APPROPRIATE?

A. Yes. Two large rate base items are prepaid pensions (a rate base asset) and other post-employment liabilities (OPEB). Because these are employee driven items, I have continued to use a labor allocation factor to separate these rate base items between distribution and transmission. However, I slightly modified the DPL version by using the distribution O&M factors to separate Delaware and Maryland rather than the gross plant factors used by DPL. I have followed the same methodology for the expense account 926, Employee Pensions & Benefits and Payroll Taxes.

Q. DID YOU MAKE ANY CHANGES TO THE O&M FACTORS?

A. Yes. I had to make a normalization adjustment to the Delaware distribution O&M expenses to recognize the difference in regulatory treatment for storm damage costs between Maryland and Delaware. As explained in response to our discovery PSC-RR-15, storm damage expenses remain in cost of service and storm expense is normalized over a three-year period, whereas, in Maryland, storm damage expenses are removed from cost of service and deferred to a regulatory asset. Because the amount of storm damage costs during the test period are large, it is important to remove these in the development of jurisdictional O&M allocation ratios to ensure consistency between Delaware and Maryland. This adjustment is only for the purposes of calculating the jurisdictional allocation ratios and not for the development of the revenue requirement which is covered in the testimony of Ara Azad and Ryan Pfaff on behalf of Staff.

Q. HAVE YOU CALCULATED THE TFR AND MMF RATIOS FOR APPLICATION TO DPL'S GENERAL AND COMMON COSTS?

A. Yes. These are provided in Table 1, below.

Table 1. Jurisdictional Factors including TFR and MMF

		Delmarva Power & Light Company		Two Factor Ratio =1					
		Allocation Factors		Mod. Mass. Formula=2					
		8 + 4 Months Ending December 2017		Enter method her	1				
(1)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Line No.			**Transmission**	**DE Distrib**	**MD Distrib**	**VA Distrib**	**Dist Total**	**Supply**	**System Total**
1		**Plant Allocators**							
2		Plant in Service	$1,311,966,686	$1,235,327,067	$954,707,405	$138,868	$2,190,173,340	$0	$3,502,140,026
3		Depreciation Reserve	$348,647,306	$353,119,618	$172,570,428	$123,880	$525,813,925	$0	$874,461,231
4		Net Plant	$963,319,381	$882,207,449	$782,136,977	$14,989	$1,664,359,415	$0	$2,627,678,796
5		Gross T&D Plant	37.46%	35.27%	27.26%	0.00%	62.54%		100.00%
6		Gross D Plant		56.40%	43.59%	0.01%	62.54%		
7		T&D Net Plant	36.66%	33.57%	29.77%	0.00%	63.34%		100.00%
8		D Net Plant Only %	0.00%	53.01%	46.99%	0.00%	100.00%		
9		Net System %	36.66%	33.57%	29.77%	0.00%	63.34%	0.00%	
10									
11		**O&M Allocators**							
12		O&M - T&D	$25,311,735	$42,150,392	$35,377,076	$0	$77,527,468		$102,839,203
13		T&D %	24.61%	40.99%	34.40%	0.00%	75.39%		100.00%
14		D O&M %		54.37%	45.63%	0.00%	100.00%		
15									
16		**Two Factor Ratio ((GP + OM)/2)**							
17		T&D %	31.04%	38.13%	30.83%	0.00%	68.96%		100.00%
18		D %		55.29%	44.71%	0.00%	100.00%		
19									
20		**Labor Allocators (2016 FF1 page 354)**							
21		Labor	$2,544,316	18,188,708	15,265,892	-	$33,454,600	$0	$35,998,916
22		T&D %	7.07%	50.53%	42.41%	0.00%	92.93%		100.00%
23		D Labor only		54.37%	45.63%	0.00%	100.00%		
24									
25		**Revenue Allocators**							
26		Total Delmarva Sales Revenues	$51,039,518	$242,639,131	$199,929,039	$0	$442,568,170	$459,124,265	$952,731,954
27		Billed Delmarva Sales Allocator %	5.36%	25.47%	20.98%	0.00%	46.45%	48.19%	100.00%
28		Billed Delmarva Sales Allocator - T&D %	10.34%	49.16%	40.50%	0.00%	89.66%		100.00%
29		Billed Delmarva Sales Allocator - D %		54.83%	45.17%	0.00%	100.00%		
30									
31		**Mod. Mass. Formula (Revenue, Plant, Labor)**							
32		T&D %	18.29%	44.99%	36.72%	0.00%	81.71%		
33		D %		55.05%	44.94%	0.00%	100.00%		

The electronic version of the workbook containing this table is set up for the user to select either the TFR or the MMF method for A&G costs. It can easily be modified to produce a mix of the two methods as well.

Q. WHAT IS THE NET EFFECT OF THE ILLUSTRATIVE CHANGES YOU HAVE MADE TO THE JURISDICTIONAL ALLOCATIONS?

A. My preferred allocation modifications utilizing the TFR method of PHISCO reduces the Delaware jurisdictional distribution rate base by $32,725,417, and reduces expenses by

$14,169,325 (before income taxes), relative to those filed by DPL. These calculations are provided in Exhibits LB-2 and LB-3, respectively. If the MMF method is used instead, the reduction to rate base would be $17,420,640 and the reduction to expenses would be $9,848,413. Although these amounts are illustrative of the importance of this issue to Delaware retail customers, the Commission could consider ordering the creation of a regulatory liability account for DPL to account for these amounts collected from DPL retail customers for disposition at a later time once the FERC jurisdictional remedies are pursued.

Q. WHAT ARE THE LIMITATIONS OF THE MMF FOR THIS PURPOSE?

A. The MMF may work fine for EBSC, but there are limitations in its use for DPL general costs, limitations that do not exist in using the TFR method of PHISCO. First, the MMF includes labor ratios as one of the three components, and I have already discussed the limitations for the DPL labor ratios that are missing the Delaware and Maryland specific levels. Second, most of the general service company costs come from PHISCO and PHISCO uses the TFR, not the MMF. Therefore, cost causation at the DPL level is more attributable to the TFR. Third, the MMF includes revenues as one of the components and for regulated companies, this becomes somewhat circular in that regulated rates and corresponding revenues are determined in part by how much general costs are allocated to the revenue center. Fourth, the TRF has been adopted by other operating companies that are part of large holding company structures. For example, Northern States Power Company, which is one of the operating utilities of Xcel Energy Corporation, has utilized the same two factor ratio method as PHISCO.

Q. WHAT ARE YOUR RECOMMENDATIONS TO THE COMMISSION ON THE JURISDICTIONAL ALLOCATIONS?

A. First, given the magnitude of the impact this will have as reflected in my illustrative results, I recommend that the Commission order the Staff to further investigate and pursue possible changes in the Company's transmission formula rate before the Federal Energy Regulatory Commission ("FERC"). Specifically, this would include, but not necessarily be limited to, pursuing a change in the use of the "Wages & Salary Allocation Factor", also known as a direct labor allocator, for the allocation of General & Common Plant and Expenses.

Second, the Commission could consider ordering the creation of a regulatory liability account for DPL to account for these amounts collected from DPL retail customers for disposition at a later time once the FERC jurisdictional pursuit is complete. This would avoid any mismatch in timing and cost recovery caused by possible changes within the FERC formula rates and changes within the Delaware jurisdiction.

Third, I recommend the Commission accept my changes in the labor allocation method employed by the Company for the jurisdictional split of general and common costs between Maryland and Delaware by rejecting DPL's use of gross plant and adopting operation and maintenance ("O&M") expense as a far more appropriate proxy for direct labor. A proxy for direct labor is required by the fact that the Company does not have direct labor values that are Maryland and Delaware specific. In this regard, the O&M expenses in Delaware must be adjusted for allocation ratio purposes only to conform to the Maryland treatment of storm damage costs.

IV. AFFILIATE TRANSACTION ACCOUNTING CONCERNS

Q. IS IT COMMON TO GIVE EXTRA REGULATORY SCRUTINY TO AFFILIATE TRANSACTIONS INCLUDED IN THE REVENUE REQUIREMENTS?

A. Yes. Because these are payments that stay within the corporate umbrella, it is very important to ensure these costs are necessary for the delivery of safe and reliable utility service and are given proper regulatory treatment. Without such scrutiny, affiliate payments could be unjustly enriching shareholders or management at the corporate level.

Q. EARLIER YOU STATED THAT AFFILIATES CHARGED OVER $375 MILLION TO DELMARVA, HAVE YOU REVIEWED SOME OF THESE CHARGES?

A. I have reviewed what DPL provided in its filing and what we have obtained in discovery. Responses to this line of discovery were somewhat limited as revealed in Exhibit LB-4, attached. Because most details were provided for the charges from the Exelon-controlled service companies, PHISCO and EBSC, I expended most my effort in trying to understand the nature of those costs.

Q. IS THE FACT THAT THESE AFFLIATE TRANSACTIONS PERFORMED UNDER THE CAM WERE AUDITED TO ENSURE CONFORMANCE WITH THE CAM SUFFICIENT TO ALLEVIATE ANY REGULATORY OR RATEMAKING CONCERNS?

A. No, because this was an audit for conformance with the CAM and is not a regulatory review for allowance or disallowance of costs. Furthermore, the audit report filed with the Commission does not provide a description of their review other than the following concluding statement ensuring conformance with the CAM:

In our opinion, management's assertion that the accompanying Summary Schedule and Schedules of Affiliate Transactions between (i) DPL and (ii) Exelon Corporation and its operating subsidiaries and PHI and its operating subsidiaries ("the Schedules"), for the year ended December 31, 2016 fairly present (i) costs allocated in accordance with the criteria set forth in the CAM as updated on April 22, 2016 and in compliance with the settlement approved in Order No. 5469 and (ii) appropriate charging of costs and transactions to participating affiliates in accordance with the criteria set forth in the CAM is fairly stated, in all material respects.[4]

Q. BASED ON WHAT YOU HAVE BEEN PROVIDED IN DISCOVERY, DO YOU HAVE ANY MATERIAL CONCERNS REGARDING THE DPL ACCOUNTING FOR AFFILIATE TRANSACTIONS?

A. Yes. Based on what has been provided thus far, the most significant concern relates to the practice of booking substantial amounts of internal service company costs to DPL's Outside Services, Account 923. The General Instructions of the FERC Uniform System of Accounts (USOA) include the following:

14. Transactions With Associated Companies (Major Utility).

Each utility shall keep its accounts and records so as to be able to furnish accurately and expeditiously statements of all transactions with associated companies. The statements may be required to show the general nature of the transactions, the amounts involved therein and the amounts included in each account prescribed herein with respect to such transactions. Transactions with

[4] PWC, Report of Independent Accountants, September 29, 2017.

associated companies shall be recorded in the appropriate accounts for transactions of the same nature. Nothing herein contained, however, shall be construed as restraining the utility from subdividing accounts for the purpose of recording separately transactions with associated companies.

For Account 923, Outside services employed, the USOA states the following:

A. This account shall include the fees and expenses of professional consultants and others for general services which are not applicable to a particular operating function or to other accounts. It shall include also the pay and expenses of persons engaged for a special or temporary administrative or general purpose in circumstances where the person so engaged is not considered as an employee of the utility.

B. This account shall be so maintained as to permit ready summarization according to the nature of service and the person furnishing the same.

Based on these excerpts from the USOA, I would think that all PHISCO and EBSC internal costs charged to DPL would be booked to the corresponding DPL account, and not Account 923, which seems to be intended for costs associated with outside contractors who are not employees of PHISCO and EBSC. In discovery, DPL admits the following:

QUESTION NO. PSC-COS-3.2

As a follow-up to "PSC-COS-1.5 Attachment 1" provided by DPL, please identify the portion of Outside Services, Account 923, assigned and allocated to DPL within JEG-3 that is comprised of internal expenses of PHISCO (e.g., PHISCO

A&G), including any itemization of those internal expenses contained within Account 923, and that portion related to third party contractors.

RESPONSE:

For January through December 2016, of the total $67M charged by PHISCO to DPL's FERC account 923, approximately 80% was related to labor and labor-related expenses such as benefits and payroll taxes, and 13% was related to contractors. For January through May 2017 actuals, approximately 71% was related to labor and labor-related expenses and 20% was related to contractors.

A similar response was provided for EBSC, although the percent of internal costs booked to Account 923 was less.

Q. WHAT REGULATORY CONCERN DOES THIS RAISE?

A. I will leave it to others to evaluate whether this is a regulatory accounting discrepancy, but I can speak to some other regulatory concerns. The reason affiliate service company costs should be booked to the appropriate corresponding DPL account is to ensure transparency and proper regulatory treatment of particular costs. A few examples of expenses that deserve special regulatory consideration include: advertising expenses, lobbying expenses, incentive compensation, and supplemental executive retirement plans (SERP). If any such costs have been bundled into Account 923, Outside Services, then it becomes difficult to identify and pull out those expenses for the regulatory consideration they deserve.

Q. DO YOU HAVE REASON TO BELIEVE THAT SUCH COSTS WERE INCLUDED IN ACCOUNT 923?

A. At this point in time I suspect that service company incentive compensation and SERP may be included in DPL's Account 923, but I am not sure whether those have been adjusted out of that Account. During the discovery phase of this proceeding, the Company seemed reluctant to provide details on affiliate transactions as reflected in the discovery responses I provide in Exhibit LB-4.

Q. WHAT IS YOUR RECOMMENDATION TO THE COMMISSION REGARDING THIS ACCOUNTING MATTER?

A. First, I recommend that the Commission order DPL to disclose all details of what is included within Account 923 including any adjustments made affecting that account in this rate case. Second, the Commission should order DPL to begin booking affiliate charges into the appropriate corresponding DPL FERC account and to cease from booking internal service company costs to DPL's Account 923.

V. CLASS COST OF SERVICE STUDY

Q. HAVE YOU REVIEWED THE COMPANY'S CLASS COST OF SERVICE STUDY AND SUPPORTING DIRECT TESTIMONY?

A. Yes. I have reviewed the Company's class cost of service study sponsored by DPL witness Elliott P. Tanos.

Q. DOES THE COST OF SERVICE STUDY COMPORT WITH ACCEPTED INDUSTRY PRACTICES?

A. The study provides a reasonable basis to guide the allocation of jurisdictional revenue requirement to the Delaware retail rate classes.

Q. WHAT METHODOLOGIES ARE USED FOR THE ALLOCATION OF DISTRIBUTION DEMAND- OR CAPACITY-RELATED COSTS?

A. DPL applies two allocation methods for this purpose. The Company has utilized the maximum diversified demand ("MDD") methodology for primary distribution accounts and the non-coincident demand ("NCP" or undiversified demand) methodology for secondary distribution accounts. An equally weighted combination of MDD and NCP was used for line transformer capacity costs.

Q. WHAT METHODOLOGIES ARE USED FOR THE ALLOCATION OF CUSTOMER-RELATED COSTS?

A. For services and metering costs, the Company utilized studies estimating the actual cost of these connecting facilities by rate class and then developed allocation factors based on those estimated cost and number of customers. This is effectively a weighted-customer methodology.

Q. HAS MR. TANOS APPLIED A LABOR ALLOCATOR METHODOLOGY FOR THE FUNCTIONALIZATION OF GENERAL PLANT AND SERVICE COMPANY ASSETS?

A. Yes.

Q. DO YOU HAVE CONCERNS REGARDING THE APPLICATION OF LABOR ALLOCATION FACTORS FOR THIS PURPOSE?

A. Yes, but not to the extent I had a concern for the jurisdictional allocation. For the retail class cost of service study, the labor allocators are effectively used to functionalize general and common costs into one of the distribution jurisdiction subaccounts. The actual allocation of the direct O&M labor costs to the rate classes follows one of the demand or customer-related allocation methods I previously discussed or is directly assigned. Therefore, a substitution for the labor functionalization factors in this instance

will not greatly impact the final allocation to each rate class because these effectively follow the demand and customer-related allocation methods. In other words, these are secondary impacts in comparison to the jurisdictional allocation for the corporation as a whole. Furthermore, similar to DPL's filing, I am recommending a mitigation to the cost of service results, which causes a deviation from a strict application of the retail cost of service study.

Q. WHAT IS YOUR RECOMMENDATION FOR THE USE OF THE COST OF SERVICE RESULTS?

A. For distribution of the revenue requirement and revenue decrease recommended by Staff Witnesses Ara Azad and Ryan Pfaff, I recommend adherence to the cost of service allocations and unity rate of return across rate classes to the extent possible without increasing rates on any one rate class.

Q. HAVE YOU PRODUCED THE REVISED RATE CLASS REVENUE REQUIREMENTS BASED ON THE DPL COST OF SERVICE RESULTS?

A. Yes. The revised rate class revenue requirements recommended by Staff are provided in Exhibit LB-5, which is a revised version of Schedule (MCS-AS)-1 filed by the Company. I revised this by first incorporating Staff's revenue requirement results from Schedule (AzP)-1.

Q. DID YOU DEVIATE FROM UNITY RATE OF RETURN FOR ANY OF THE RATE CLASSES?

A. Yes. Strict adherence to the cost of service allocations would have produced large rate increases for residential space heating customers and primary voltage general service customers. I set both of those to current revenue levels within the model. I then

increased the rates of the customers that would have received the largest rate reduction under unity rate of return, the small secondary voltage general service customers, to make up for the reduced revenue from residential space heating and primary voltage customers. These deviations from unity rate of return are made transparent on page 1 of Exhibit LB-5.

VI. RATE DESIGN AND RECOMMENDED RATES

Q. HAVE YOU REVIEWED THE RATE DESIGN AND RECOMMENDED RATES FILED BY THE COMPANY?

A. Yes. The Company's proposed rate design and rates are sponsored by DPL witness Marlene C. Santacecilia.

Q. RELATIVE TO CURRENT RATES IS THERE ANY NOTABLE CHANGES IN THE RESIDENTIAL RATE DESIGN PROPOSED BY THE COMPANY?

A. Yes. The Company had proposed an increase in the customer charge for residential customers. However, with Staff's recommended rate reduction, I believe it is reasonable to hold the residential customer charge at the current approved level and apply the rate reductions to the distribution energy charges.

Q. HAVE YOU PRODUCED THE REVISED RATES RECOMMENDED BY STAFF?

A. Yes. Staff's recommended rates are provided in pages 3-8 of Exhibit LB-5. These are reflective of the revenue requirement and revenue allocation recommendations of Staff.

Q. DOES THIS CONTAIN YOUR PROOF OF REVENUE FOR EACH RATE CLASS?

A. Yes.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.